IFRS Accounting

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Compilation of Agenda Decisions

Volume 8

Published by the IFRS Interpretations Committee

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Volume 8
(November 2022—April 2023)

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Introduction

Compilation of Agenda Decisions—Volume 8 compiles all agenda decisions published by the IFRS Interpretations Committee (Committee) in the period November 2022 to April 2023. The Committee publishes an agenda decision to explain why a standard-setting project has not been added to the work plan to address a question submitted. For ease of reference, the agenda decisions are sorted by IFRS Accounting Standard.

How the Committee supports consistent application of IFRS Accounting Standards

The Committee works with the International Accounting Standards Board (IASB) in supporting the consistent application of IFRS® Accounting Standards.

The Committee's process

Committee projects typically begin as an application question submitted for consideration. The process is designed to:

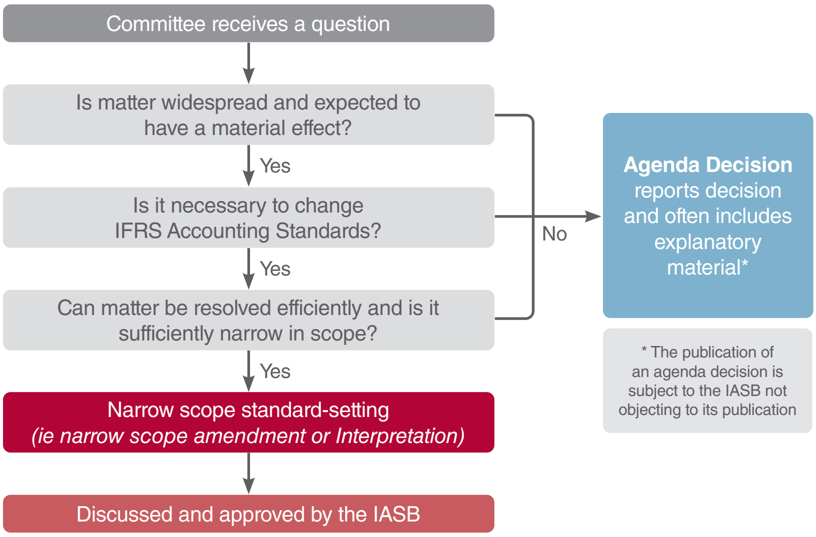
- allow any stakeholder to submit a question for consideration; and
- be transparent—all eligible application questions are considered at a public meeting.

The Committee then decides whether a standard-setting project should be added to the work plan to address the question submitted. The Committee may decide not to do so if it concludes that standard-setting would be:

- unnecessary—typically because, in the Committee's view, IFRS Accounting Standards provide an adequate basis for an entity to determine the required accounting or because there is no evidence that a widespread financial reporting problem exists; or
- not sufficiently narrow in scope—the question could be resolved only as part of a larger IASB project (not a narrow-scope project).

To explain why a standard-setting project is not added, the Committee publishes an agenda decision. Agenda decisions report the Committee's decision and, in many cases, also include explanatory material.

The following diagram summarises the criteria the Committee considers when deciding whether a standard-setting project should be added to the work plan:



Explanatory material in an agenda decision

Agenda decisions often include explanatory material. The objective of including such explanatory material is to improve the consistency of application of IFRS Accounting Standards.

Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Accounting Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Accounting Standards apply to the transaction or fact pattern described in the agenda decision.

Explanatory material derives its authority from the Standards themselves. Accordingly, an entity is required to apply the applicable IFRS Accounting Standard(s), reflecting the explanatory material in an agenda decision (subject to it having sufficient time to implement that accounting).

Explanatory material included as part of a tentative agenda decision is subject to comment. The comment period is normally 60 days. After considering comments received, the Committee decides whether to confirm its decision and publish an agenda decision (subject to the IASB not objecting). An agenda decision is published if no more than three IASB members object to its publication. Please visit the project pages on our website if you would like more information about the agenda decisions included in this compilation.

Agenda decisions published by the Committee are available on the 'how the IFRS Interpretations Committee helps support consistent application of IFRS Accounting Standards' page.

Narrow-scope standard-setting

Some questions result in narrow-scope standard-setting that follows the applicable due process. The Committee may decide to:

- develop an IFRIC Interpretation, which adds requirements to IFRS Accounting Standards but does not remove or replace any requirements in the Accounting Standards; or
- recommend that the IASB develop a narrow-scope amendment to an Accounting Standard.

Narrow-scope standard-setting projects recommended by the Committee and approved by the IASB are added to the work plan as maintenance projects.

IFRS 16 *Leases*

Definition of a Lease—Substitution Rights (IFRS 16)

April 2023

The Committee received a request about how to assess whether a contract contains a lease. The request asked about:

a. the level at which to evaluate whether a contract contains a lease—by considering each asset separately or all assets together—when the contract is for the use of more than one similar asset; and

b. how to assess whether a contract contains a lease applying IFRS 16 when the supplier has particular substitution rights—ie the supplier:

    i. has the practical ability to substitute alternative assets throughout the period of use; but

    ii. would not benefit economically from the exercise of its right to substitute the asset throughout the period of use.

The definition of a lease

Paragraph 9 of IFRS 16 states that 'a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration'. Applying paragraph B9 of IFRS 16, for a contract to meet the definition of a lease the customer must have both:

a. the right to obtain substantially all the economic benefits from use of the identified asset throughout the period of use; and

b. the right to direct the use of the identified asset throughout the period of use.

The period of use is 'the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)' (Appendix A to IFRS 16).

Paragraph B12 of IFRS 16 states that 'an entity shall assess whether a contract contains a lease for each potential separate lease component' and directs an entity to paragraph B32 of IFRS 16 for application guidance on separate lease components. Paragraph B32 specifies that the right to use an underlying asset is a separate lease component if both:

a. the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee; and

b. the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

Identified asset

The first requirement for a contract to meet the definition of a lease is that a customer controls the use of an identified asset. Paragraphs B13–B20 of IFRS 16 provide application guidance on an identified asset.

Paragraph B13 states that 'an asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer'.

But 'even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use' (paragraph B14). In that case, the supplier—rather than the customer—controls the use of the asset. Consequently, there is no identified asset; the contract does not contain a lease.

For a substitution right to be *substantive*, paragraph B14 states that both of the following conditions must exist:

a. the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and

b. the supplier would benefit economically from the exercise of its right to substitute the asset (ie the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

Paragraph B16 states that 'an entity's evaluation of whether a supplier's substitution right is substantive [...] shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur'.

Paragraphs B15–B18 specify requirements that mean, in each of the following situations, a supplier's substitution right is *not* substantive (or the customer is not precluded from having the right to use an identified asset):

a. the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event;

b. the supplier would benefit economically from the exercise of its right only on the occurrence of a future event that, at inception of the contract, is not considered likely to occur; or

c. the supplier has a right or an obligation to substitute the asset only for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available.

Paragraph B17 notes that the costs of substitution are more likely to exceed the associated benefits when the asset is located at the customer's premises or elsewhere.

Paragraphs BC112–BC115 of the Basis for Conclusions on IFRS 16 explain the IASB's rationale in developing the requirements on substitution rights. Paragraph BC113 states that 'the IASB's intention in including [these requirements] is to differentiate between:

a. substitution rights that result in there being no identified asset because the supplier, rather than the customer, controls the use of an asset; and

b. substitution rights that do not change the substance or character of the contract because it is not likely, or practically or economically feasible, for the supplier to exercise those rights'.

Paragraph BC113 goes on to explain that, at the time of developing IFRS 16, the IASB was of the view 'that, in many cases, it will be clear that the supplier would not benefit from the exercise of a substitution right because of the costs associated with substituting an asset'.

Paragraph B19 requires the customer to presume that a supplier's substitution right is *not* substantive if the customer cannot readily determine whether the supplier has a substantive substitution right. Paragraph BC115 notes:

a. the requirement in paragraph B19 responds to stakeholders concerns that 'in some cases it would be difficult, if not impossible, for a customer to determine whether a supplier's substitution right is substantive'.

b. 'if substitution rights are substantive, then the IASB thinks that this would be relatively clear from the facts and circumstances'.

Consequently, the Committee observed that the requirements in paragraphs B13–B19 set a high hurdle for a customer to conclude that there is no identified asset when an asset is explicitly or implicitly specified.

The Committee also observed that determining whether a supplier's right to substitute an asset is substantive *throughout* the period of use, as required by paragraph B14, requires judgement. Paragraph B14(a) specifies that a supplier has the practical ability to substitute alternative assets throughout the period of use even if the supplier does not already have alternative assets but could source those assets within a reasonable period of time. This illustrates that the term 'throughout the period of use' does not mean at all times within that period.

Applying the requirements in IFRS 16 to the fact pattern described in the request

In the fact pattern described in the request:

a. *a customer enters into a 10-year contract with a supplier for the use of 100 similar new assets —batteries used in electric buses. The customer uses each battery together with other resources readily available to it (each battery is used in a bus that the customer owns or leases from a party unrelated to the supplier).*

b. *it is assumed that the supplier has the practical ability to substitute alternative assets throughout the contract term such that the condition in paragraph B14(a) exists.*

c. *if a battery were to be substituted, the supplier would be required to compensate the customer for any revenue lost or costs incurred while the substitution takes place. Whether substitution is economically beneficial for the supplier at a point in time depends on both the amount of compensation payable to the customer and the condition of the battery.*

d. *at inception of the contract, it is expected that the supplier would not benefit economically from substituting a battery that has been used for less than three years but could benefit economically from substituting a battery that has been used for three years or more.*

The level at which to evaluate whether a contract contains a lease

In the fact pattern described in the request:

a. the customer is able to benefit from use of each asset (a battery) together with other resources (a bus) available to it; and

b. each battery is neither highly dependent on, nor highly interrelated with, the other batteries in the contract.

Therefore, the Committee concluded that, in the fact pattern described in the request, applying paragraph B12, the customer assesses whether the contract contains a lease—including evaluating whether the supplier's substitution right is substantive—for each potential separate lease component, ie for each battery.

Identified asset

In the fact pattern described in the request, each battery is specified. Even if not explicitly specified in the contract, a battery would be implicitly specified at the time it is made available for the customer's use. Therefore, the Committee observed that, unless the supplier has the substantive right to substitute the battery throughout the period of use, each battery is an identified asset.

In the fact pattern described in the request, the condition in paragraph B14(a)—the supplier has the practical ability to substitute alternative assets throughout the period of use—is assumed to exist. The Committee observed, however, that because the supplier is not expected to benefit economically from exercising its right to substitute a battery for at least the first three years of the contract, the condition in paragraph B14(b) does not exist throughout the period of use. Therefore, the supplier does not have the substantive right to substitute a battery throughout the period of use. While determining whether a supplier's substitution right is substantive throughout the period of use can require judgement, the Committee observed that the facts and circumstances in this fact pattern are such that it is clear that the supplier's right is not substantive throughout that period.

The Committee's conclusion

The Committee concluded that, in the fact pattern described in the request, each battery is an identified asset. To assess whether the contract contains a lease, the customer would then apply the requirements in paragraphs B21–B30 of IFRS 16 to assess whether, throughout the period of use, it has the right to obtain substantially all the economic benefits from use, and direct the use, of each battery. If the customer concludes that the contract contains a lease, it would apply the requirements in paragraphs 18–21 of IFRS 16 to determine the lease term.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to evaluate the level at which to assess whether the contract contains a lease and whether there is an identified asset in the fact pattern described in the request. Consequently, the Committee decided not to add a standard-setting project to the work plan.

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